



IAIS Issues *Timely Paper* on *Captive Regulation*

Written by Karrie Hyatt

With the steady growth of captives and the addition of dozens of captive domiciles in the last two decades, regulation of all types of captives has been a worldwide concern. Late last year, the International Association of Insurance Supervisors (IAIS) released a guidance paper aimed to help captive regulators oversee their domicile's captives.

The first attempt to help guide captive regulators by the IAIS was in 2006 when the original *Application Paper on the Regulation and Supervision of Captive Insurers* was released. The updated version released last year was developed over several years with input from the association's members. It delves deeper into captive insurance than the original report and goes on to describe many important qualities of regulation that are specific to captive insurance companies, while offering advice for captive regulators to develop a successful supervisory approach to captive regulation.

The updated version of the Application Paper comes at an important time in the captive industry—with the rapid addition of new domiciles, especially in the United States, the pool of experienced regulators is not keeping up with demand and can be a major obstruction for proper oversight of captive activities.

Since 2000, nineteen U.S. states have added captive law to their books and several states have rebooted their captive programs to take advantage of the burgeoning market. Following hand-in-hand is the lack of young talent entering the industry. While the captive industry is still relatively new to the insurance market, those who run it are seasoned professionals. While the industry scrambles to train up new talent, the problem becomes more severe on the side of regulation. Experienced captive insurance regulators are

even less common and as new captive programs struggle to get implemented as fast as companies are trying to form captives, there is a real gap in education and experience.

The IAIS's Application Paper means to shore up that gap. The IAIS is an organization of insurance supervisors and regulators from more than 200 jurisdictions in 140 countries. Members include the National Association of Insurance Commissioners (NAIC) and 56 jurisdictions in the U.S. and its territories. IAIS was established in 1994 to be the "international standard setting body responsible for developing and assisting in the implementation of principles, standards and other supporting material for the supervision of the insurance sector," according to the IAIS website. Its mission is similar to that of the NAIC but on a global scale. The IAIS works to provide consistent

standards of regulation of the insurance industry worldwide to help "develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability."

To this effect, the *Application Paper on the Regulation and Supervision of Captive Insurers* seeks to shore up inconsistencies in captive regulation. Over a period of several years the IAIS worked with members through its committees to develop the Application Paper. During the summer of 2015, it released a draft of the paper for member comment.

Among the ten companies and captive jurisdictions that submitted detailed comments, the Delaware Department of Insurance's comment sums up the timeliness of the Application Papers' release:

"Presently there is continuous growth not only in the number of captive insurers, but more importantly for purposes of this Paper, growth in the number of captive insurance domiciles. However, the growth in experienced captive insurance regulators has not kept pace and therefore experienced regulators are in short supply. While this Paper will assist the experienced regulator, it will be even more important for the new captive regulator because it will provide a blueprint for effective regulation."

This "blueprint" is based on IAIS's Insurance Core Principles (ICPs) which aim to "provide a globally accepted framework for the supervision of the insurance sector," as described in the organization's mission statement.

One of the most important points in the Application Paper is that it recognizes that not all captives are the same and will need different levels of supervision. It acknowledges that every captive has a unique set of risks and that they should not all be regulated the same. The way the IAIS defines a captive is fairly straight-forward and it recognizes four types of captives: pure captives, group and/or association captives, rental captives, and diversified captives. Diversified captives are defined as "captives writing a limited proportion of unrelated business in addition to the risks of their owner and/or affiliates." Most U.S. domiciles do not allow for this type of captive.



The Application Paper offers guidance to allow regulators the flexibility to approach supervision in a practical way depending on the varying amount of risk of the captive company. In its comment letter, the NAIC supported this provision of the Paper, saying, "Supervisors in jurisdictions with captives should have the authority to address, as necessary and appropriate, the Insurance Core Principles and Standards outlined in the IAIS paper. However, jurisdictions must maintain discretionary authority to supervise each captive as appropriate for that captive's particular situation (i.e., apply proportionality). The action that is appropriate for one captive may not be appropriate for another."

In addition to suggesting that regulators match their supervision to the level of risk, the Application Paper also provides advice regarding reporting requirements, reinsurance supervision, third-party administrators, working with a captive's parent company, and adequate capital requirements.

It also takes pains to describe how good corporate governance can differ from traditional insurers. This includes making sure that the roles that the parent company, the captive board, and the captive manager are clearly stated and defined; that there are internal controls for risk management; and that the board understands what their obligations are.

With the release of the *Application Paper on the Regulation and Supervision of Captive*, regulators—both new and experienced—now have a comprehensive guide to creating well-crafted supervisory systems. In the comment letter submitted to the IAIS by Willis Global Captive Management's CEO Paul Owens, he said, "We see even greater value in the paper moving beyond 'supervisors should consider' recommendations to stating what is international best practice. This will provide clearer guidance and facilitate closer alignment of regulatory regimes." ■

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